



# **ECONOMIC REGULATION OF AIRPORTS**

**RAAA SUBMISSION TO THE PRODUCTIVITY  
COMMISSION**

**SEPTEMBER 2018**

## **CONTENTS**

<b>INTRODUCTION.....</b>	<b>2</b>
<b>EXECUTIVE SUMMARY .....</b>	<b>4</b>
<b>KEY POINTS .....</b>	<b>5</b>
<b>MARKET POWER OF AUSTRALIAN AIRPORTS .....</b>	<b>7</b>
<b>EFFECTIVENESS OF THE CURRENT MONITORING REGIME .....</b>	<b>13</b>
<b>ALTERNATIVE APPROACHES TO THE CURRENT REGIME .....</b>	<b>21</b>
<b>ACCESS AT MAJOR AIRPORTS FOR REGIONAL OPERATORS.....</b>	<b>23</b>
<b>CONCLUSION .....</b>	<b>25</b>
<b>RECOMMENDATIONS .....</b>	<b>26</b>
<b>ATTACHMENT A: .....</b>	<b>27</b>
<b>RAAA Submission to the ACCC – Brisbane Airport RDMS</b>	

# INTRODUCTION

## The RAAA

The RAAA was formed in 1980 as the Regional Airlines Association of Australia to protect, represent and promote the combined interests of its regional airline members and regional aviation throughout Australia.

The Association changed its name in July 2001 to the Regional Aviation Association of Australia (RAAA) and widened its charter to broaden the membership which now includes the businesses that support regional aviation. RAAA members operate in all states and territories and include airlines, airports, aeromedical operators, engineering and flight training companies, aircraft manufacturers, fuel providers, finance and insurance companies and government entities. Many RAAA members provide employment and contribute towards economic sustainability within regional areas. The membership includes large domestic companies as well as internationally based multi-national organisations.

The RAAA members collectively provide a broad range of aviation services to regional Australia and many have done so since before privatisation of the airports. Members' experience encompasses airline and non-airline operations at the four monitored airports, the other major city airports, secondary airports and regional airports.

The RAAA has 33 Ordinary members (AOC holders) and 65 Associate/Affiliate members. The RAAA's AOC members directly employ over 5,000 people and indirectly support the employment of many others. Many of these jobs are in regional areas. On an annual basis, the RAAA's AOC members jointly turnover more than \$1b, carry well in excess of 2 million passengers and move over 23 million kilograms of freight.

## The RAAA Charter

The RAAA's Charter is to promote a safe and viable regional aviation industry. To meet this goal the RAAA:

- promotes the regional aviation industry and its benefits to Australian transport, tourism and the economy to government and regulatory policy makers;
- advocates on behalf of the regional aviation industry and its members;
- contributes to government and regulatory authority policy processes and formulation so that its members have input into policies and decisions that may affect their businesses;
- encourages high standards of professional conduct by its members; and
- provides a forum for formal and informal professional development and information sharing.

The RAAA provides wide representation for the regional aviation industry by direct advocacy to Ministers and senior officials, through parliamentary submissions, personal contact and by ongoing, active participation in a number of consultative forums.

## **Regional Air Services**

Over 4 million regional Australians rely on regional air services. Without these services the social and economic existence of regional and remote communities and many regional industries are at risk. Servicing this need are regional operators who service more communities in Australia than the major domestic operators and provide:

- essential access to markets and services;
- aeromedical assistance and health services;
- transport & freight services;
- bushfire and Search & Rescue operations;
- exploration via airborne surveying;
- pipeline and other infrastructure inspections;
- business & recreational travel;
- airport facilities; and
- flying training.

Our operator members use a diverse range of aircraft types, including but not limited to:

- Regional airlines: operating aircraft types from 9 seat twin engine piston aircraft to 100 seat jet aircraft.
- Air freight operators: operating types from turboprops to large jet aircraft.
- Aeromedical operators: operating modern single and twin engine turboprops and jet aircraft.
- Charter operators: operating a wide range of aircraft from light single engine piston aircraft to 100 seat jet aircraft.
- Flying schools operating light single and twin piston engine training aircraft.

These aircraft are operated to and from a large number of airports around the country including the price monitored airports, other major city airports, capital city secondary airports, major regional airports and smaller community airports.

Each of our operator members is also a tenant of at least one category of airport. Our Associate Members include the full range of supporting businesses including aircraft distributors, fuel companies, finance houses, insurance brokers, law firms, repair and overhaul businesses and seven regional airports.

Some of our associate members are also tenants of airports. Noting this background, the RAAA has considerable experience of the behaviour of the privatised airports.

## EXECUTIVE SUMMARY

The RAAA maintains that, with few exceptions, Australian airports are monopolies by nature and that an effective monitoring and control regime is needed to prevent abuse of market power. Even in those cases where airports do not currently abuse their monopoly position there is no guarantee that this will always be the case in the future. Major airports are motivated by the need to maximise margins for their stakeholders and all too often Council owned regional airports regard their local airport as a cash generating unit rather than an essential community transport service.

The current light handed monitoring regime has not been effective in curtailing the abuse of market power by the major airports. Despite the existence of the monitoring regime the major airports continue to impose excessive price increases and generate consistently high profits. Specific recommendations by the ACCC to limit the abuse of market power have not been implemented and the monitoring regime itself has been significantly reduced in scope over the years. The second tier self-administered monitoring regime is not considered effective and secondary airports and regional airports are not monitored at all.

The RAAA supports a negotiate-arbitrate approach to the regulation of airports in Australia. There should also be a limit on airports being able to charge operators for new infrastructure which in many cases is not justified and simply adds unnecessary cost. Further it submits that airport monitoring should be extended to:

- all Australian capital city airports and;
- regional airports above a predetermined passenger movement threshold and;
- benchmarking measures should be adopted to assess airport operating costs, charges and profits.

On the basis that non-monitored airports could have the ability to charge operators margins on assets that have been inflated through technical accounting methods, the RAAA recommends that reporting and monitoring requirements should be enhanced requiring Airport Operators to provide information on the written down economic value of their assets and the methodology used to separately allocate assets to aeronautical and non-aeronautical services.

Under the existing charging structure, Airport Operators could charge Airline Operators for non-aeronautical services, which could be services that are not required by the Airline Operator. There is a strong argument that Airline Operators should not be paying for non-aeronautical infrastructure/services or other infrastructure they do not require as part of their operations.

In this submission the RAAA does not specifically address domestic terminal leases, airport car parking, landside access, land transport linkages or competition in jet fuel supply. However it is aligned with A4ANZ and fully endorses its submission. Two of the RAAA's largest members, Virgin Australia Regional Airlines (VARA) and Regional Express (Rex) are also members of A4ANZ.

## KEY POINTS

RAAA members' experience of airports since privatisation has been largely negative, with some exceptions. In fact, the RAAA membership now includes 7 airports and we have excellent working partnerships with them.

All too often however, the relationships can be characterised by inappropriate use of airports' market power in the form of unreasonable price increases, lack of consultation, lack of adequate consideration of operational needs, loss of security of tenure, loss of amenity and the ability to negotiate fairly and reasonably.

Most airports today, including airports other than the four monitored airports, are natural monopolies and the inappropriate use of airports' market power is not uncommon. The current airport monitoring and reporting mechanisms are in need of significant review.

The 2011 Productivity Commission inquiry found that regulatory oversight had been effective to date and recommended a further review in 2018. The current Inquiry is welcomed by the RAAA and in particular it is felt very appropriate that the Terms of Reference now extend beyond the four major monitored airports to include regional airports.

The Terms of Reference focus on the special arrangements for NSW regional services to access Sydney Airport which is understandable given the specific legal mechanisms that exist for these services. However, the RAAA feels that it is just as important to examine regulatory arrangements for all regional airports where there is similar opportunity for the abuse of market power.

In this context the secondary airports in capital cities should not be excluded as some of them have been responsible in the past for gross abuses of market power in terms of forcing small operators, flying schools and associated aviation enterprises like maintenance providers off their airports in order to concentrate on more profitable non-aviation enterprises.

A mechanism is urgently needed to ensure airports and users of airports can reach the equivalent of fair and reasonable market based outcomes despite the absence of competitive forces.

RAAA members believe the current Inquiry is a welcome and much needed initiative from Government to address adverse outcomes relating to monopoly powers exercised by airport operators in the provision of aeronautical services and facilities.

The RAAA believes that fair and reasonable access to aeronautical services and facilities is currently not always possible, in part due to inherent limitations within the current regulatory regime.

## **Feedback concerning the RAAA submission**

In order to be effective, the RAAA relies on feedback from its members. When concerns are being raised, the RAAA seeks examples to illustrate members' issues.

There is no question that members are arguing for substantial improvements in the economic regulation of airport services. However it is worth stating that in gathering information for this submission, only a relatively small number of members have provided examples to demonstrate the inappropriate use of monopoly power by airport operators. Some members have not provided examples because they are seriously concerned about the potential adverse ramifications if the examples enter the public domain and are negatively received by the relevant airports. This concern remains despite the assurance by the Productivity Commission that specific examples can be incorporated into a confidential submission that will not be published.

A significant number of RAAA members are concerned that airport operators are in a position to adversely impact without recourse their business' viability by the withholding of, or manipulation of, costing and terms of aeronautical services and facilities. Members' concerns are understandable given the already challenging dynamics of the regional aviation sector (e.g. large capital investment costs, narrow profit margins, high regulatory barriers, significant competitive forces, and relatively high levels of risk), the fact that regional operators typically have limited bargaining power and the prohibitively expensive processes for legal redress.

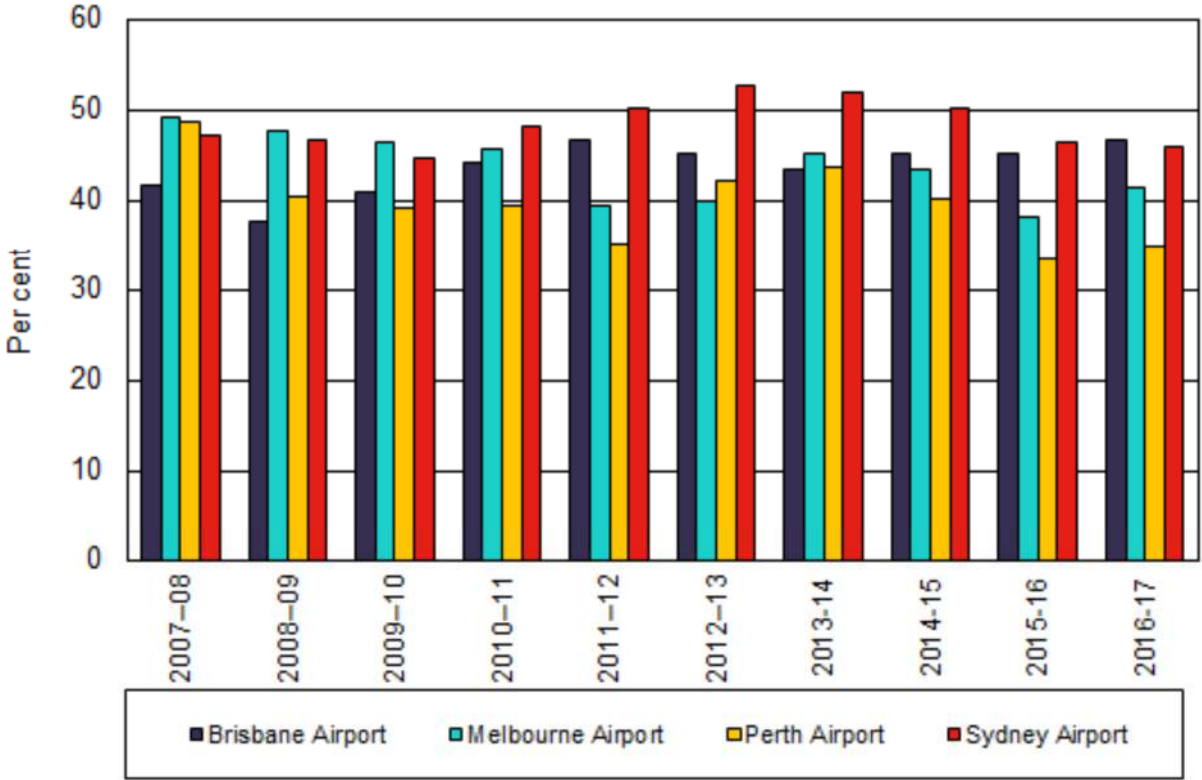
# MARKET POWER OF AUSTRALIAN AIRPORTS

## Airport services and the impact on regional aviation

The experience of RAAA members is that the cost of airport and airport related services is a key impediment to the continuing provision of services by regional airline operators and other industry participants. Monopoly pricing and other monopoly practices deter investment and impose unjustified costs and inefficient conditions on regional operators, adversely affecting their economic viability and the continuing existence of the regional aviation network.

In general Australian airports are in a natural monopoly position by virtue of geography. In other developed countries such as the US or in Europe the distance between airports is much closer allowing for a choice by passengers or by operators. Major population centres are serviced by two or more airports allowing for some competition. Low cost carriers such as Ryanair or EasyJet are able to exploit this by shopping around for the best deal and routing their services accordingly. However in Australia, with few exceptions, there is no choice.

This has allowed Australia’s major airports to generate consistently high profits even during economic downturns. It was notable that during the Global Financial Crisis the four major Australian airports maintained their margins while many operators were struggling to survive. The ACCC’s Airport Monitoring Report 2016 - 2017 shows that the airports are not affected by the economic environment, which is only made possible by their monopolistic position.

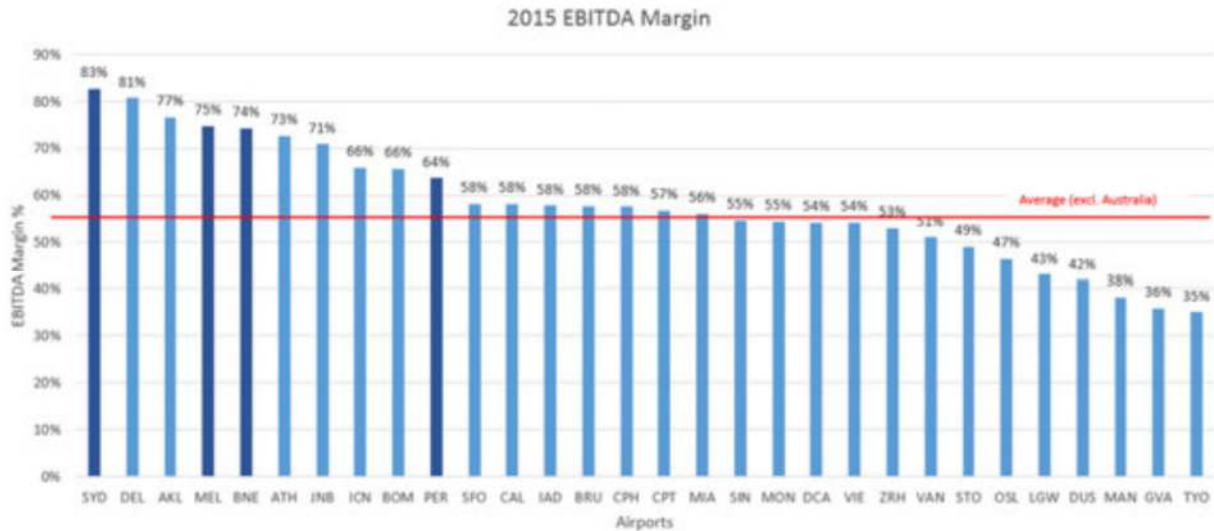


Aeronautical profit margins in real terms: ACCC Airport Monitoring Report 2016-2017



High profit margins are seen as an indicator of market power being exercised. This is further illustrated by the fact that the four major airports are amongst the most profitable in the world according to figures published by IATA.

**Average EBITDA margins (2015) for Australian airports higher than average**



Source: Data for 2015, available from Leigh Fisher 2016 and 2017 reports.

While consistently high profits point to monopolistic behaviour it is felt that other indicators include excessively high increases in charges and the imposing of unnecessary charges.

Of significance is the fact that aeronautical revenue per passenger continues to increase despite significantly increasing passenger numbers which means that no economies of scale are being realised. BITRE figures show an increase of 34% in total passenger numbers for the four airports from 2007-2008 to 2016-2017 and yet ACCC figures show that average revenues per passenger increased by 25.9 per cent in real terms across the four major airports in the same period. These increases have not been accompanied by corresponding increases in airport service levels according to the ACCC report. An exception to this is Perth Airport which has shown an increase in service level in recent years, albeit with a 61.8% increase in real terms in aeronautical revenue per passenger over the last six years.

In summary aeronautical revenue per passenger at Australia’s four major airports rose by between 15% and 58% in real terms between 2008 and 2017. IATA claims that for Australian domestic travel, per passenger charges on an average airfare increased by two-thirds between 2007 and 2017, from AUD7.65 to AUD12.75.

Of concern to the RAAA is the building block model employed by the major airports where all new airport investment in infrastructure is categorised as Necessary New Investment and is added onto existing Passenger Use Charges. This can be for items as everyday as replacing the tiles in a passenger terminal bathroom or upgrading the seats in a common area up to major airport works such as re-sheeting taxiways and aprons. It is a unique business model that can levy charges on a cost plus basis for maintenance of existing facilities and investment in new facilities and one that could only exist with an excess of market power.

Equally of concern is the tendency for the major airports to pre fund large projects such as new runways by charging operators in advance. This is a unique model and could only be contemplated in an environment where an airport has excessive market power. Normal capital

raising practices should be applied rather than loading up operators with excessive charges which may not benefit all airport users. The RAAA strongly advocates that this practice be discontinued and urges the Productivity Commission not to endorse it.

Given the lack of a monitoring regime, data for other major airports and regional airports is not so readily available. However there are many examples of excessive airport fee increases being experienced by RAAA members. Typically these are done with little or no consultation. A4ANZ reports that a survey conducted by the Australian Airports Association revealed that less than half of regional airports consulted with airlines prior to undertaking capital work programs that inevitably led to increased charges. The same survey revealed that 86% of regional airports give only three to six months notice of increases to fees when tickets have already been sold. This mirrors the experience of RAAA members.

Fee increases at regional airports are usually justified by the need to realise a Return on Investment (ROI) or the need to cover depreciation for capital works. Aerodromes were gifted to local Councils during the eighties and nineties under the Aerodrome Local Ownership Plan (ALOP) along with some funding for upkeep. The RAAA recognises that the funding has long since expired but does not agree with the practice of revaluing an airport obtained for nothing and then charging the operators for depreciation. Similarly many local airports obtain federal and/or state government funding for improvements or upgrades and again pass on the depreciation costs to operators. All too often operators are not consulted on the suitability of such capital works and quite often they are simply white elephants which the airport insists that operators pay for. Such practices could only occur where there is an excess of market power.

#### Case Study 1

##### **Mt Gambier Airport**

In 2010 Mount Gambier Airport notified Regional Express (Rex), without prior consultation, that it was imposing a 46% increase in head tax for the FY11 following previous increases of 9% and 8% in FY09.

This was done on the basis that it was needed to cater for charter planes and larger aircraft like those operated by QantasLink which could not operate into Mt Gambier without the upgrade.

Rex was therefore expected, through increased charges, to cover the cost of an upgrade which provided no benefit to its operations and which was designed to attract a competitor to the airport.

Passenger numbers at Mt Gambier are not high enough to support two operators and the extra cost to passengers has resulted in a decrease in passenger numbers through the airport. The lack of consultation and the imposing of unnecessary price increases are an example of excess market power.

Very recently, after intervention by the local state member, Rex has managed to come to a partnership arrangement with Council regarding future fee increases but it would have been better if proper consultation had taken place prior to the increases being imposed.

Rex has experienced similar issues at other regional airports such as Mildura, Orange and Kangaroo Island and these are covered in detail in their submission

Case Study 2

**King Island Airport**

In June 2018 King Island Council undertook a review of its airport charges that will result in an increased annual cost to Rex of \$127,000, effective from 1 October 2018. This approximately double the existing airport charges and is not sustainable for what to Rex is a low volume route.

The new charges included substantial increases to the landing charges as well as the introduction of a head tax. Figures published by King Island Council on revenue raised from all operators show an anticipated increase from \$399,426 (FY18) to \$826,246 (FY19) or a whopping 207%. The budget for FY20 anticipated a further 27% increase.

According to Council the basis for the increase was a need to recover a book loss resulting from a revaluation of the capital value of the airport precinct from \$3.2m to \$11.9m. The airport's book loss was almost all due to the resulting extra depreciation. The attempt to recover this is hard to understand given that the airport was gifted to Council under the ALOP.

The lack of consultation and the imposing of an unreasonably high increase is indicative of excess market power.

Case study 3

***In Confidence***

## Security Costs

Airport security and the cost that comes with it has long been a fact of life in the major airports and it is now being extended to larger regional airports. Recent changes by the federal government mean that some airports will have to introduce the same security regime that we see at capital city airports with passenger screening and checked bag screening. The government is providing some funding for the capital costs of the equipment but is not providing any funding for annual operating costs or for installation costs. Operating costs, including manpower, are considerable and installation costs will mean the redesign of baggage handling areas and in some cases major redesign of airport terminals to cater for the required sterilised passenger areas.

Irrespective of the new requirements for security at regional airports the government exempted all airline and charter aircraft with less than 40 passenger seats. These aircraft are not required to have their passengers or baggage screened. However some regional airports have already stated that they will charge all operators for security whether they require it or not. This is already the case at capital city airports and at some regional airports like Tamworth and Dubbo. The charges at the major airports are not prohibitive due to economies of scale but at regional airports they will be punitive and will force some smaller operators to abandon thin routes they are currently servicing.

This was not the intent of government when implementing the new security rules and such unfair charges are only possible where there is an abuse of market power. It is not necessary as other airports have solved the issue by implementing an approved Transport Security Program where secure and unsecure passengers can be processed simultaneously thus obviating the need to screen passengers on aircraft that don't require it. Where this is not possible due to the physical terminal layout some regional airports have opted to screen all passengers but not charge those who do not require it.

### Case Study 4

#### Dubbo Airport

In 2012 QantasLink introduced a single daily service to Dubbo using Q400 aircraft. Under government security rules this aircraft type required screening whereas all remaining QantasLink flights using Q300 aircraft and all Rex flights using SAAB 340 aircraft were not required to be screened.

However Dubbo Airport decided to screen all departing passengers and baggage and charge accordingly despite the fact that the majority of flights did not require it. Dubbo Airport opted not to institute simultaneous screened and unscreened flights as permitted by the Transport Security Regulations and as practiced by some other regional airports.

Rex was thus forced to pay for costs incurred as a result of a commercial decision by a competitor and is now charged for an aeronautical service that it does not need and does not want. This is clearly an abuse of market power and costs Rex an extra \$320,000 p.a.

## Regional Airports and Lack of Transparency

Due to the lack of a monitoring regime there is often no transparency with regard to regional airports' revenue and costs. In some cases these are hidden in Council's general financial statements and it is not possible to tell exactly what profits (or losses) are being made by the

airport. It is also not always possible to tell on what basis charges are being levied and whether costs are real or if they are questionable costs put in place by technical accounting methods.

There is a need to separate costs associated with aeronautical and non-aeronautical services to ensure that operators are not charged for non-aeronautical services and that margins aren't unduly high. The RAAA would like to see reporting and monitoring requirements enhanced requiring Airport Operators to provide information on the written down economic value of their assets and the methodology used to separately allocate assets to aeronautical and non-aeronautical services.

Regional airports operated by Councils are essential transport infrastructure and vital to rural communities. While they are in a position of possessing market power there is always the temptation for Council to treat their local airport as a cash generating unit or profit centre or to simply require a ROI for an asset that was gifted to them. The local airport is essential transport infrastructure and no different to the roads that Council maintains and should be viewed in the same way.

It is acknowledged that not all airports are the same and some do see their airport as a community asset and not a financial asset (or liability). It is also acknowledged that smaller rural centres will always struggle to fund necessary airport maintenance.

### **The Importance of Regional Services**

This is recognised by different Governments and various schemes exist to assist in the provision of regional air services. At the Commonwealth level there is the Enroute Charges Scheme, the Remote Aviation Access Program and the Remote Areas Services Subsidy while at the State level there are some route subsidies, notably in Queensland. These generally target very remote areas but regional aviation also provides essential air services in not so remote areas.

A number of local governments value the need for essential air services by partnering with small airline operators to open new routes or re-establish closed routes through incentive deals in relation to passenger charges or other start-up costs. Some have assisted the introduction of routes by arranging meetings with and surveying local businesses to gauge the level of support for a new or re-introduced route. For example, Essendon Airport and Sharp Airlines and Coffs Harbour Airport and Corporate Air.

#### Case study 5

##### **Essendon Airport**

Essendon is in close proximity to Melbourne Airport and has to compete with them to attract airline and corporate operators. When it became apparent that existing operators at Essendon were experiencing difficulties with arrivals and departures due to airspace conflicts with Melbourne Airport, Essendon engaged an independent expert at their own expense to consult with Airservices Australia in order to improve the Air Traffic Services into their airport.

While the RAAA takes nothing away from Essendon Airport management, who are genuinely interested in fostering aviation at their airport, it must be noted that this is a rare case where market power does not exist.

## EFFECTIVENESS OF THE CURRENT MONITORING REGIME

RAAA members' experience at the four monitored airports since the implementation of the light handed monitoring regime in 2002 has overall been a negative one. It has been characterised by massive price increases, lack of adequate consideration of operational needs, and the loss of security of tenure, amenity and the ability to negotiate.

Notwithstanding the monitoring and reporting regime, the major airports have excessive market power and are not prevented from using it. It is also clear that the existence of market power and the preparedness to use it is not limited to the major airports, monitored or otherwise.

As noted earlier, this excessive market power and the associated fear of retribution has in some cases been responsible for operators feeling unable to pursue complaints or even to provide evidence to this Inquiry.

In its Airport Monitoring Report 2016-2017 when anticipating the current inquiry the ACCC states that:

*In the past the ACCC has raised concerns that the current monitoring regime did not provide an effective constraint on the airports' market power.*

The RAAA believes this is still the case and that the existing regime is not appropriate and does not deter potential abuses of market power by airport operators.

Whilst airport monopoly power was intended to be moderated by various regulatory provisions (i.e. the Airports Act 1996, the particular terms of the airport leases, Part IIIA and Part VIIA of the Competition and Consumer Act 2010, the regional airline protections at Sydney airport and the monitoring regime under the ACCC) it is apparent from experience that the current regulatory controls are substantively inadequate and fail to achieve economically efficient outcomes because they:

- do not adequately acquit the Commonwealth's rights and obligations as owner and lessor of the airports on behalf of the Australian people;
- do not extend to airports other than the four monitored airports;
- do not protect aviation infrastructure from being negatively impacted by commercial developments;
- do not ensure fair pricing, access, service provision or transparency for all industry providers who require access to the airport;
- do not have adequate regard for the need to encourage investment in the whole aviation sector;
- are too expensive for small operators and are open to tactical abuse such that outcomes can be delayed and other commercial pressures can be brought to bear to impede fair outcomes; and
- focus heavily on passenger related aspects of aviation ignoring other very economically important industry participants and services such as freight handling and maintenance providers.

*In Confidence*

Clearly events such as this demonstrate that the current system is not working, even at a monitored airport.

Given the importance of regional aviation services to the national economy, regardless of ownership, the RAAA feels that the Commonwealth Government should take a keen interest in the overall economic health and viability of the regional network. Whether airports are owned or controlled by the government or other parties, they are essential national infrastructure, and the government should ensure that this infrastructure will provide the services necessary for future generations.

Moreover, having regard to the Commonwealth Government's ongoing ownership of the major privatised airports, the RAAA feels that, as owner and lessor, it should ensure that the airport network continues to operate efficiently and that effective mechanisms are in place to guarantee regional access into the future.

In the view of RAAA members, the lease conditions on each airport, the interpretation of those conditions and the review processes implemented by the government to ensure the conditions are complied with by airport lessees, are not well understood and are not transparent.

The provisions of the Competition and Consumer Act 2010 in theory provide some protection but in practice do not. To mount a Part IIIA case against an airport is a challenge for large operators but for small regional operators is an impossibility. They simply do not have the financial resources to carry out such protracted and expensive legal proceedings. Such proceedings are extremely lengthy and, apart from the cost, small regional operators may not have the time to wait out such proceedings.

Considering the reliance of regional communities on having reliable air services into major airports the RAAA asks the following questions:

- What are the Commonwealth's rights and obligations as owner and lessor of the airports?
- Are the applicable airport leases sufficiently detailed and if not, what additional detail is required?
- How can the leases and review processes be made more transparent and more robust?

## **Airports other than the four major monitored airports**

The RAAA welcomes the Commission's Inquiry into the major airports (Brisbane, Melbourne, Perth and Sydney) and the fact that *'it will also consider regulatory arrangements affecting Australia's regional airports'* as stated in the issues paper. In the context of this Inquiry the RAAA submits that the market power exercised by the secondary airports is very relevant to assessing the effectiveness of the current monitoring and reporting regime.

Understandably, the inquiry has a focus on the arrangements for maintaining NSW regional access into Sydney Airport given the current regulatory regime that exists at Sydney for regional operators. However the RAAA wishes to highlight the market power held by other major airports, capital city secondary airports and regional airports. All are essential to the ongoing viability of regional air services and all need to be subject to some form of effective regulatory oversight that ensures the curtailing of excessive market power.

In the experience of RAAA members, airports that are not major airports have market power in their geographic market and, with no or limited regulatory oversight, are capable of using that market power with little or no fear of redress by an operator or government.

As mentioned earlier, some local government airport operators treat their airports as cash generating units or profit centres and insist on a ROI or a dividend being returned to them. There is the example of Mildura Airport which has been incorporated by its owner and is obliged to return a dividend to Council each year. The latest round of fee increases by Mildura Airport has resulted in Rex withdrawing its Mildura to Sydney service as unfortunately it had no form of redress for the airport's actions. This is not conducive to maintaining reliable and affordable air services.

Apart from essential regional air services, airports are used by other aviation service providers such as flying schools and maintenance shops. This is particularly so for the capital city secondary airports and other non-monitored major airports. Prior to privatisation Canberra Airport, for example, had six flying schools. There are now none and the increase in fees and charges was a significant factor in their demise.

Regional airports may only account for around 10% of passenger movements Australia wide but they provide a vital link between rural communities and the rest of Australia and are essential infrastructure within the national economy.

Case study 7

***In Confidence***



## **Aviation infrastructure being negatively impacted by commercial development**

It is clear that airport operators are highly motivated by the need to maximise returns from their real estate. They now hold the annual Australasian Airports Real Estate and Planning Conference which was commenced in 2004. We do not deny them the right to gain returns from non-aeronautical real estate ventures and it could even be positive if such returns were to be used to facilitate aeronautical capital investment but unfortunately this is rarely the case. The airports invariably rely on airline operators or, in the case of regional airports, government grants to provide such funding.

While not begrudging the airports the right to earn extra profit it must not be done at the expense of airport infrastructure.

Sometime in 2007 Sydney Airport proposed a Master Plan with extensive non-aeronautical development including a DFO. Given the scarcity of land at Sydney Airport the Transport Minister withheld approval and the plan was subsequently modified. Fortunately in this case there was Government oversight but the intentions and priorities of the airport were clear.

In 2006 the operators of Bankstown Airport closed runway 18/36 and associated airport infrastructure. Two years later in 2008 they closed Hoxton Park aerodrome and turned it into an industrial park with some residential development. These actions removed crosswind runways near Bankstown and again showed that the owner's priority was with real estate development.

### Case study 8

#### **Canberra Airport**

For Canberra Airport, Airservices Australia has been obliged to put the following warning in its En Route Supplement Australia:

*"During strong westerly winds TURB may be experienced in touch down area LDG RWY 35"*

This warning of turbulence resulted from airline pilots complaining about a safety issue arising from severe turbulence caused by a hangar that was built too close to the runway. The hangar could have been placed further away from the runway if the land behind the hangar was not being used for non-aeronautical commercial development.

Additionally, the ATSB undertook an investigation as a result of an Air Safety Incident Report relating to severe wind turbulence over the threshold of Runway 12 at Canberra due to buildings being too close to that threshold. The report was released in 2011 and noted significant shortcomings and a commensurate reduction in safety as a result of poor consideration of the effect of non-aeronautical developments near Runway 12.

It must be noted that some airports achieve the balance between aeronautical and non-aeronautical development and Essendon Airport is a good example where significant non-aeronautical development has taken place without compromising aeronautical infrastructure.

## **Fair pricing, access, service provision and transparency**

The RAAA submits that the current light handed monitoring and reporting regime fails to manage abuse by airport operators of their market power or to balance investment incentives against fair and transparent outcomes. They also fail to address other important factors vital to the overall health of the aviation network and industry.

With many airport owners or leaseholders subject to commercial imperatives and limited or non-existent regulatory controls, airport owners typically seek to maximise shareholder returns without regard to the overall aviation industry and its customers.

Where the monitoring regime exists, airport pricing is a dual till model and some transparency results. However transparency drops away where secondary and regional airports are concerned.

Many airports do not consistently share their pricing models for the use of aviation related infrastructure and there are few airports that share pricing models in relation to airport essential services that are not direct aviation services (e.g: property rents, car parking charges for on airport employees etc.). And yet these related services can be important to the viability of an airport tenant.

Additionally, under a common charging regime smaller operators are often left with no choice but to pay for airport infrastructure that they do not require. This can be upgraded runways and taxiways provided for larger aircraft (which may not even be utilising the airport), enlarged passenger terminals provided for larger aircraft or security services which by law they do not require. Under this system the expansion of a large operator at an airport can mean that a small operator at the same airport will end up paying a higher per passenger rate and yet receive a lower standard of service (e.g: parking on aprons located away from the terminal requiring expensive bussing arrangements).

RAAA members have experienced adverse outcomes relating to monopoly powers exercised by airport operators in the provision of aeronautical services and facilities, outcomes that would not realistically occur in a competitive market. These include:

- A declining lack of security of tenure for airport lessees and tenants;
- Former lessees being refused exercise of options or renewal of leases and being offered tenancies of built facilities at higher rents where those facilities may not suit the tenant's business as well as the resumed lease premises;
- Terms of leases declining from the former FAC standard of 25 years + 5 years + 5 years (or more) to as little as 12 months;
- Unreasonable purpose clauses in renewed leases or new tenancies and unduly restrictive interpretation of existing purpose clauses notwithstanding existing condoned use;
- Unreasonable enforcement of reversionary leases which effectively deprive lessees and tenants of their property improvements for little or no recompense to the benefit of the airport operator;
- Denying reasonable access to leased sites as a way of pressuring potential lessees to improve basic common infrastructure that the lessor ought to provide;
- Offering leases to new and existing lessees on greenfield sites and demanding that the lessee pay for the access infrastructure; and

- Ramping up rentals with little regard to the price in a real market, often with no transparency as to what the market on the particular airport is

## Pricing of Services

Where pricing models are transparent and there is a capacity to negotiate the costs that are fed into the model, a commercially negotiated market solution is possible. That unfortunately, is not always practiced by airports.

Pricing models can be distorted by the arbitrary revaluation of assets, particularly land. A trend is emerging amongst regional airports to have their assets revalued on a piecemeal basis, often resulting in a figure several times the original valuation, and then on-charging the resulting hefty increases in depreciation. This is seen by the industry as a pure cash grab and an abuse of market power. Case study 2 is an example.

Since privatisation there have been changes to the way rents are determined by airport landlords. In situations where the annual CPI based increases plus periodic reviews have been continued, there have often been unrealistic assertions as to what the market is, with little transparency as to comparative rates on the particular airport. Operators are told that off airport comparisons are not applicable and are offered 'take it or leave it' rents which can be considerably inflated. Such increases can be claimed to be based on supposed infrastructure improvement costs to the airport, however improvements are done without consultation with the affected lessees and often the lessee has been expected to pay for or provide access infrastructure which will revert to the airport.

### Case study 9

#### Sydney Airport

In December 2005 Sydney Airport notified Rex of a 30% increase in its hangar rental based on the rent paid by surrounding airport tenants. Rex objected on the basis that the surrounding rents were artificially set by the airport but a reduction in the increase was refused and Rex activated the dispute clause in their lease. Protracted negotiation ensued and an agreement was reached for a 16% increase in April 2008. The next year in July 2009 Sydney Airport imposed a 29% increase. Again protracted negotiations ensued with mutual agreement finally being reached in Jan 2011. Other tenants were not as fortunate as Rex and had to pay greatly increased rents.

The practice of an airport benchmarking a high rent and then leapfrogging surrounding tenants' rents over each other is considered an abuse of market power. Charges such as hangar rents for regional airlines are not necessarily declared under the Competition and Consumer Act.

**Footnote:** It must be emphasised that Rex considers recent and current management at Sydney Airport work well with aviation tenants and negotiations on rents and tenure are now conducted professionally and positively. The practice described above, which is not confined to Sydney Airport, has ceased but without an adequate regulatory regime could be resumed in the future under new management or ownership.

The ability to increase rents excessively is based on the monopoly market power the airport has in relation to operators or service providers who must be on the airport to serve their customers and operate their businesses.

## **Security and terms of tenure**

It is impossible for a business to plan properly if it has insufficient security of tenure and no reasonable confidence that the future costs of its business premises are predictable.

With this in mind RAAA members, including aircraft operators and the providers of services to operators, are extremely concerned regarding security and terms of tenure on privatised airports.

Lessees with relatively long leases and one or more options for extension have been:

- pressured to surrender those leases;
- denied reasonably anticipated options;
- denied reasonably expected renewals (even if this requires relocation); or
- offered renewals that are inappropriate to their businesses

## **Reversionary Leases**

The practice of using reversionary leases is not questioned as it is normal and reasonable for a lessor to require a lessee to remove improvements to leased land or for the lessor to assume ownership of improvements at the end of a lease.

The difficulty airport lessees have is that airport operators are abusing this reasonable business practice with short leases, uncertain options and renewals, and gold-plated building requirements.

The combined effect of a short term lease and the depreciation rules for taxation purposes is that at the end of the lease the tenant is effectively gifting a partially depreciated building to the airport operator. This had not been the case prior to privatisation and it might be argued that the lessee should have understood the changed risk. In a perfect market that would be fair comment. In a market deformed by monopoly it ignores the realities.

Examples exist of airports utilising subjective interpretation of lease clauses to refuse consent to the transfer of an existing lease to a willing and able purchaser of a business on an airport.

Thereafter the airport exercises the reversionary terms of the lease effectively depriving the business proprietor of his goodwill asset and in most cases significant capital improvements and investment.

There are cases where this practice has been used to turn an existing lease into a tenancy, thus reducing the incoming business's security of tenure, and to exact rents far higher than provided for in the determined lease because the airport operator without any capital investment on their part is able to offer the premises as improved premises.

When this occurs in the case of fuel depots it allows an airport to take over all fuel facilities on site and create a monopoly with regard to the airport's fuel supply. It then introduces a throughput tax based on revalued assets. This increases the cost of fuel at that airport with no alternative for operators that formally enjoyed the benefits of competition.

### **Provision of Infrastructure**

It is common for commercial or government entities to offer leasehold with appropriate access infrastructure to be used for the proposed purposes of the lease. The costs of the provision of this infrastructure is typically recovered through the pricing of the lease rent.

A number of airport operators, however, are charging rents at the high end of any reasonable market comparison and then requiring the lessee to fund access infrastructure or build that infrastructure themselves. In several examples airports have proposed that the tenants would subsequently incur ground rent for roads, taxiways and tarmacs that could be argued are common user infrastructure.

## ALTERNATIVE APPROACHES TO THE CURRENT REGIME

The RAAA argues that the current regime has not been effective in constraining the market power of airports. This is self-evident in that the majority of airports in Australia are not subject to any type of regulation. Those that are have been progressively reduced to the current four largest capital city airports and the light handed monitoring and reporting regime in existence for them has been ineffective in that there are no enforcement provisions.

The RAAA acknowledges that some airports have not exercised undue market power and have worked well with airlines and other operators but as management and ownership change this could also change. As air traffic grows the larger airports will become more and more restricted for land and slots and there will be increasing incentives for them to force out smaller less profitable operators. The system must be designed for the worst case.

A regime is needed that identifies the abuse of market power, prevents excessive price increases and prevents unnecessary or unjustified charges. e.g: charges that are forcibly levied on an operator for services that are not required and not wanted.

It should allow for transparency of airport costs when charges are being formulated and a reasonableness test needs to be applied to such methodology. For example, applying inflated revaluation to assets that were obtained at zero cost by an airport for the purposes of massively increasing depreciation and consequently airport charges is not considered reasonable.

Other essential aviation service providers have been subject to rigorous regulatory controls to prevent abuse of market power. Airservices Australia, for example, must have all fee increases approved by the ACCC. This has led to a regime where Airservices conducts rigorous and effective consultation with operator stakeholders and fee increases have been reasonable while still allowing Airservices to return a dividend to the Government. Needless to say they are restricted from making super profits.

However, the RAAA recognises that any such regime must be workable and to declare all charges at all airports would obviously be far too costly and too bureaucratic. A more light handed and practical approach is needed.

The RAAA supports the proposals put forward by A4ANZ for an alternate regulatory regime. It supports the negotiate/arbitrate model with the inclusion of Final Offer Arbitration and offers the following comments:

- Airport monitoring should be extended to all Australian capital city airports and all regional airports above a predetermined passenger movement threshold.
- An applicability test should apply to charges on new infrastructure which is not required and not wanted by an operator.
- Benchmarking measures should be adopted to assess airport operating costs, charges and profits.
- The monitoring regime should ensure that airports provide information on the written down economic value of their assets and the methodology used to separately allocate assets to aeronautical and non-aeronautical services.

- Airline Operators should not have to pay for non-aeronautical infrastructure or services or other infrastructure they do not require as part of their operations.

Regarding the arbitration method proposed by the A4ANZ the RAAA supports the use of the arbitration mechanism in Division 3 of Part IIIA of the Consumer and Competition Act. It supports the inclusion of a new section 192 in the Airports Act to deem all aeronautical services and facilities, as defined in regulation 7.02A of the Airports Regulations, to be declared services for the purposes of Division 3 of Part IIIA.

If negotiations failed this would allow the ACCC to make a binding determination using Final Offer Arbitration. It is considered significant that in this process the ACCC is empowered to terminate an arbitration if the party who notified the dispute has not engaged in negotiations in good faith or if the ACCC considers that access to the service should continue to be governed by an existing contract between the parties. The RAAA feels that the very existence of the above arbitration mechanism will encourage both parties to conduct negotiations in good faith and on a commercial basis.

The A4ANZ proposal covers three main methods by which the new section 192 could capture the relevant services to be subject to a deemed declaration:

1. All services under regulation 7.02A could be made declared services for the purposes of Division 3 of Part IIIA. The RAAA favours this solution as being the simplest and most workable with the proviso that regulation 7.02A be reviewed from time to time to ensure all relevant services are captured.
2. Only services under regulation 7.02A where it is considered that an airport operator had substantial market power would be deemed for the purposes of Division 3 of Part IIIA. The RAAA does not favour this method as it agrees with the A4ANZ's conclusion that it could lead to unnecessary and costly legal disputation. The RAAA considers this the least favourable option.
3. A Minister or other authority could deem specific services for the purposes of Division 3 of Part IIIA. The RAAA feels this is introducing unnecessary bureaucracy and potential political influence and does not favour this option.

Arbitration under Part IIIA can be time consuming and the RAAA would support any move to reduce the specified time limits.

Notwithstanding the above the RAAA has a concern that arbitration under Part IIIA could prove to be too costly for small operators, particularly when considering the deep pockets of the major airports. If this should prove to be the case and there is no way to constrain the cost another approach may also be considered.

The Commonwealth Administrative Appeals Tribunal or similar mechanism such as an appropriately resourced and informed industry ombudsman or arbitrator supported by relevant legislation could be more suited to minor disputes.

The RAAA submits that a model for resolution of such disputes as suggested by the Victorian Civil and Administrative Tribunal in the case of *Bema Gold (Australia) Pty Ltd and Moorabbin Airport Corporation* under the Victorian Retail Leases Act 2003 is worthy of consideration.

## **ACCESS AT MAJOR AIRPORTS FOR REGIONAL OPERATORS**

The ring fencing of slots at Sydney Airport and the Declaration of aeronautical facilities and services was designed to preserve NSW regional services into and out of Sydney Airport and has undoubtedly been a success. Without such protection regional airlines such as Rex and Fly Pelican would not be operating at Sydney today.

The financial incentive for large capacity restricted airports like Sydney to force out small airlines are huge when it is considered that a 34 seat or 19 seat aircraft occupies a slot that could be filled by a large international or domestic operator which generates far more revenue for the airport.

Sydney Airport has in the past argued that this does not make economic sense and has pushed for regional airlines to be relocated to Bankstown on productivity grounds. This ignores the fact that the rules for preserving NSW regional air services were in place when the current operators of Sydney Airport purchased the lease from the Commonwealth and were part of the deal. It is another money grab at the expense of NSW regional residents who have made it very clear that access to Sydney Airport is very important to them.

In 2010 Sydney Airport proposed huge increases for GA, helicopter and regional operators parking aircraft in the eastern parking areas which was clearly designed to force GA, corporate and regional operators out of the airport in favour of the larger carriers. It used these charges as at the time they were not covered by the Declaration for regional airlines. In the event they were withdrawn by SACL in the course of an ACCC case but the intent was clear and without ACCC oversight the airport would have been free to exercise its market power.

It is therefore absolutely essential that price protection remain in place for regional operators at Sydney Airport as it has clearly been successful in its intent of allowing access to Sydney for NSW regional air services.

Consideration must be given to extending this arrangement or similar to other capital city airports as the volume of air traffic continues to increase and inevitably capacity constraints increase along with the pressure on airport operators to replace regional aircraft movements slots with more lucrative domestic and international movements.

Equally the ring fencing of slots at Sydney Airport has been successful in preserving access to the airport overall and specifically in preserving access during peak periods. Typically regional business passengers will travel into the city early in the day during the morning peak and depart late in the afternoon during the evening peak. For this reason regional airlines go to the extra expense of overnighing their aircraft and crews at outports so they can schedule flights accordingly and without regional slots during the peak periods it would not be possible.

For the reasons described above plus flight connectivity, regional airlines get very strong feedback from regional communities and Councils that they regard access to Sydney Airport as essential and do not want it replaced by services to Western Sydney Airport.

Importantly, the fact that the Sydney regional ring fencing is enshrined in legislation protects it from interference by the airport which could reduce or remove NSW regional access. An example of the way a slot scheme can be used by an airport to curtail smaller operators is the scheme introduced by Brisbane airport where they have introduced discriminatory rules for smaller aircraft.



Brisbane Airport has refused to grant historical slot precedence for aircraft operating scheduled (Fly-In Fly-Out) charter services if they have less than 50 seats. This precludes 34 seat and 19 seat operators from bidding for these contracts because they cannot guarantee to keep a contracted schedule as the airport has the right to take a slot away from them if the operator of a larger aircraft wishes to utilise it. This is a clear abuse of market power and seemingly requires legislation to prevent it. The RAAA took this case to the ACCC but was unsuccessful. For background information the RAAA submission is attached at Appendix A.

## CONCLUSION

The RAAA contends that almost all Australian airports are in a position to exercise market power. In particular, Australian regional airports are a long way apart and operators and customers cannot exercise choice when flying from a regional centre.

The current light handed monitoring and reporting regime provides some degree of transparency with regard to the monitored airports but is not effective in preventing the abuse of market power. Non-monitored airports have even more freedom to inappropriately exercise their market power.

Not all airports choose to abuse their monopoly position and there are some that actively encourage aviation and work in partnership with operators. However the current light handed regime needs to be extended in coverage and scope in order to ensure that abuse of market power cannot and does not happen. With regard to regional aviation services some measure of control is required for secondary airports and regional airports.

Airport users are not confined to just airlines and their passengers but consideration must be given to the effect of excessive market power on freight operators, aeromedical services, charter operators, flying schools and essential service providers such as refuellers and maintenance organisations.

The RAAA favours the encouragement of commercial negotiations with airport operators under a negotiate-arbitrate regime utilising Part IIIA of the Competition and Consumer Act with Final Offer Arbitration by the ACCC.

It is considered that the protection afforded to NSW regional air services into and out of Sydney Airport through regional ring fencing and the declaration of aeronautical services has been largely effective and that consideration needs to be given to similar protection at other major airports as air traffic continues to expand and they come under increasing commercial pressure to remove low yield customers.

Airports are a vital part of Australia's transport infrastructure and are essential for the economic and social fabric of the nation. As such more priority should be given to the availability and affordability of aviation services than to maximizing returns to airport stakeholders.

## RECOMMENDATIONS

The RAAA recommends that:

1. The regulatory regime should be extended to all capital city airports, secondary airports and regional airports above a predetermined passenger movement threshold.
2. An applicability test should apply to charges for new infrastructure which is not required and not wanted by an operator.
3. Benchmarking measures should be adopted to assess airport operating costs, charges and profits.
4. The monitoring regime should ensure that airports provide information on the written down economic value of their assets and the methodology used to separately allocate assets to aeronautical and non-aeronautical services.
5. Airline Operators should not have to pay for non-aeronautical infrastructure or services or other infrastructure they do not require as part of their operations.
6. A new section 192 be included in the Airports Act to deem all aeronautical services and facilities, as defined in regulation 7.02A of the Airports Regulations, to be declared services for the purposes of Division 3 of Part IIIA of the CCA.
7. A negotiate-arbitrate mechanism to be adopted with the ACCC making binding determinations using Final Offer Arbitration.
8. The regional ring fencing and price cap or equivalent mechanisms be maintained at Sydney Airport and consideration be given to similar controls at other major capital city airports as capacity becomes constricted.
9. That the imposition of throughput tax on monopoly fuel supplies by airports be subject to the regulatory regime the same as charges for deemed aeronautical facilities and services.

## **ATTACHMENT A:**

### **RAAA SUBMISSION TO THE ACCC JANUARY 2013**

#### **- BRISBANE AIRPORT RUNWAY DEMAND MANAGEMENT SCHEME**